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MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

PERIODS ENDED JUNE 30, 1989

PLEASE RETURN

MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

PERIODS ENDED JUNE 30, 1989

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APPOINTIVE OFFICIALS

Charles A. Brooke, Lottery Director

L. John Onstad, Lottery Assistant Director for Security

LOTTERY COMMISSION

		TERM EXPIRES
Spencer Hegstad, Chairman	Dillon	January 1, 1990
Pat DeVries	Polson	January 1, 1991
Jim Moore	Bozeman	January 1, 1990
William Ware	Helena	January 1, 1993
Rebecca Erickson	Glasgow	January 1, 1993

LOTTERY LIAISON COMMITTEE

Senator Hubert Abrams	Wibaux
Senator Ethel Harding	Polson
Representative Linda Nelson	Medicine Lake
Representative Norman Wallin	Bozeman

REPORT DISTRIBUTION

According to Section 23-5-1007(7), MCA, copies of this report must be distributed to the following individuals.

Stan Stephens, Governor

Dave Ashley, Acting Director, Department of Administration

Scott Seacat, Legislative Auditor

Jack Galt, President of the Senate

John Vincent, Speaker of the House

The law also states "the President of the Senate and the Speaker of the House will determine the report distribution to each member of the appropriate committee of each house of the legislature". The President of the Senate and the Speaker of the House requested this report be distributed to the Revenue Oversight Committee. In addition, the Speaker of the House requested this report be distributed to the House Business and Economic Development Committee.

Members of the Revenue Oversight Committee include:

Senators	Representatives
Bill Norman, Chairman	Susan Good, Vice Chairman
Bruce Crippen	Dan Harrington
Dorothy Eck	Robert Hoffman
Thomas Hager	Jim Patterson
Joe Mazurek	Ted Schye
Robert Brown	Robert Ream

The House Business and Economic Development Committee members include:

Representatives	
Bob Pavlovich, Chairman	Gene DeMars, Vice Chairman
Fred Thomas	Bob Bachini
William Glaser	Thomas Nelson
Stella Jean Hansen	Lloyd "Mac" McCormick
Bruce Simon	Norm Wallin
Clyde Smith	Rob Blotkamp
John Johnson	Vernon Keller
Tom Kilpatrick	Don Stappler

Lottery
Montana
(406) 444-LUCK

August 28, 1989

To The Montana Lottery Commission:

The Montana Lottery took a number of steps to improve sales and retailer relations during the fourth quarter of 1989. The first of these undertakings, was to launch an aggressive advertising campaign. We also organized focus groups and lead an effort to have Montana's membership into Lotto*America approved. The draft Request For Proposal for an on-line system for Montana was also issued during this quarter.

"Centennial Gold Rush" became the first game with a prize payout over 45%. It went on sale June 28, 1989. Paying out 55% of ticket sales as prizes, this game had the potential of producing more Montana winners than any other game.

The Marketing Division, with the assistance of Operations, designed a retailer incentive program to pay retailers an increased commission based on an incremental increase in sales.

Operations' staff implemented changes in the accounts receivable system which now gives retailers approximately four weeks from the delivery of tickets to pay for those tickets.

A new, more attractive, monthly newsletter was designed for Lottery retailers.

These accomplishments resulted in a slight increase in sales during the quarter. But even more importantly they are the first steps in achieving our ultimate goal of maximizing the net revenue transferred to the Superintendent of Public Instruction.

Sincerely,

Charles A. Brooke
Director

2525 N. Montana, Helena, MT 59601-0542

MONTANA LOTTERY
BALANCE SHEET
JUNE 30, 1989

ASSETS	(Unaudited)
Cash	$ 786,702
Receivables (Net)	664,497
Inventories	133,974
Equipment	732,921
Other Fixed Assets	4,093
Accumulated Depreciation	(241,706)
Intangible Assets	593,031
Other Assets	6,338
TOTAL ASSETS	$ 2,679,850

LIABILITIES AND FUND EQUITY	
Liabilities:	
Accounts Payable and Accruals	$ 78,577
Lottery Prizes Payable	1,505,143
Due to Other Funds (Note 2)	378,918
Installment Purchase/Lease Payable	354,488
Compensated Absences Payable (Note 1)	74,789
Allowance for Ticket Returns	287,964
	$ 2,679,879
FUND EQUITY:	
Retained Earnings Unreserved	(29)
Total Fund Equity	(29)
TOTAL LIABILITIES AND FUND EQUITY	$ 2,679,850

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
PERIODS ENDED JUNE 30, 1989

	Quarter Ended June 30, 1989 (Unaudited)	Twelve Months Ended June 30, 1989 (Unaudited)
OPERATING REVENUES:		
Charges for Service		
Net lottery ticket revenue	$ 2,489,845	$ 11,644,061
License and permits	650	3,600
Total Operating Revenues	2,490,495	11,647,661
Prizes and Commissions		
Prize expense	(1,181,791)	(5,300,097)
Retailer commission	(149,172)	(669,313)
Net Operating Revenue	$ 1,159,532	$ 5,678,251
OPERATING EXPENSES:		
Amortization	$ 53,229	$ 179,289
Personal Services	210,903	903,995
Contractual Services	50,925	216,047
Cost of tickets sold	286,365	630,843
Audit Fees	11,977	53,293
Supplies and Materials	16,527	72,611
Depreciation	28,736	114,994
Utilities and Rent	22,723	93,677
Communications	14,183	65,192
Advertising	96,459	231,536
Travel	12,514	35,873
Repairs and Maintenance	19,230	75,634
Management Service Fee	22,010	71,446
Other	1,844	13,479
Total Operating Expense	$ 847,625	$ 2,757,909
Operating Income	$ 311,907	$ 2,920,342
NONOPERATING REVENUES (EXPENSES)		
Interest Expense	(196)	(914)
Total Nonoperating Revenues (Expense)	(196)	(914)
Income before Operating Transfers	311,711	2,919,428
Operating Transfers In (Out)	(306,410)	(2,774,692)
NET INCOME (LOSS)	$ 5,301	$ 144,736
Retained Earnings, Beginning of Period (Note 5)	-0-	(139,435)
Prior Period Adjustments (Note 6)	(5,330)	(5,330)
RETAINED EARNINGS, END OF PERIOD	$ (29)	$ (29)

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
Notes to the Financial Statements (Unaudited)
JUNE 30, 1989

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity.

The Montana Lottery, established under the provisions of Section 23-5-1001, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets went on sale June 24, 1987.

The Montana Lottery is operated by a five member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer regional lottery games and prepare financial reports.

Basis of Presentation. The Montana Lottery reports its financial activity in accordance with generally accepted accounting principles (GAAP) as prescribed in pronouncements of the Governmental Accounting Standards Board (GASB).

Enterprise Fund.

The Montana Lottery is classified as an Enterprise Fund of the governmental Proprietary Fund Type. Enterprise Funds account for operations: a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Basis of Accounting. The Montana Lottery's financial statements are prepared using the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable.

Receivables. Receivables totalling $664,497 represent amounts owing the Lottery for purchased tickets. An allowance for doubtful accounts is usually based on historical perspective. Because of immaterial uncollectible account balances, an allowance for doubtful accounts has not been established.

Receivables also include $16,762 in retailer commissions related to estimated ticket returns.

Inventories. Inventories consist of merchandise, Instabuck and supplies inventories. Merchandise inventory includes lottery tickets valued at $78,305 stored in the warehouse and with the marketing representatives. These ticket inventories are recorded at cost using the specific identification method and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold when sold. After game end and awaiting disposal, unsold tickets are charged to cost of tickets sold.

Merchandise inventory includes a $9,882 adjustment related to estimated ticket returns.

Supplies inventories include paper supplies, ticket dispensers, premiums and point-of-sale materials having a value of $5,000 or more. At quarter end, supplies inventories totaled $45,787. These inventories are also recorded at cost using the specific identification method.

Compensated Absences. State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Vacation leave may be accumulated not to exceed two times the maximum number of days earned annually. With no limit on accumulation, sick leave is earned at 12 days per year. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave. The Lottery's payable for compensated balances is detailed below.

Balance June 30, 1988	Net Leave Earned Used	Balance June 30,1989
$74,705	$ 84	$74,789

Allowance for Ticket Returns. This allowance represents a liability as of June 30, 1989 for estimated ticket returns. Ticket sales have been increased by approximately $287,963 for net estimated ticket returns for the quarter ended June 30, 1989. Prize expense has been adjusted by approximately $129,829. Commissions and cost of goods sold have also been adjusted for expenses associated with this allowance.

Revenue Recognition. Lottery ticket sales are recorded as revenue based on ticket deliveries to the retailers. In accordance with an established policy, retailers may return unsold tickets to the Lottery for credit. Sales have been reduced by an allowance for estimated ticket returns.

Free Tickets. The Montana Lottery's instant games award free tickets as prizes. Net lottery ticket revenue does not include the value of free tickets given away and free plays won. The face value of these free tickets distributed approximated $484,454 for the quarter ended June 30, 1989.

Instabucks. Instabucks are a Lottery coupon good, upon redemption, for a lottery ticket. Instabucks, used to stimulate lottery ticket sales, are usually given away for promotions, retailer clerk incentive programs, and advertising trade-outs. The lottery tickets distributed resulting from Instabuck redemptions are reflected as a reduction in revenue. The related prize expense and ticket cost are reclassified as an advertising expense. For the quarter ended June 30, 1989, Instabuck redemptions resulted in a revenue reduction of $48,753 and a prize expense reclassification of $22,028.

Coupons. Occasionally, the Lottery promotes ticket sales by distributing coupons as matches for instant prizes. Cash prizes related to the coupons are included in the prize structure. Free ticket prizes awarded due to a coupon match are reflected as a reduction of revenue. For the quarter ended June 30, 1989, free ticket prizes awarded with a coupon match resulted in a revenue reduction of $145.

Prizes. Expenses for instant prizes are recorded based on the predetermined prize structure for each game. No prize expense is recorded for free tickets distributed.

Commissions. Retailers receive a five percent commission on tickets or chances sold. Commission expense is recorded based on the face value of tickets delivered to the retailers.

Amortization. The Instant Lottery System (ILS) software, classified as an intangible asset, is being amortized over a period of five years using the straight line method. The Media Drop-In Productions, Inc. contract for the use of ten lottery advertisements, is also classified as an intangible asset. This contract is being amortized over a period of 3 years using the straight line method.

2. DUE TO OTHER FUNDS

The account "Due to Other Funds" totalling $378,918 reflects the $306,410 payable to the State Superintendent of Public Instruction and $72,508 due to other state agencies for goods and services provided through fiscal year end. The $306,410 transfer for the quarter ended June 30, 1989 was paid on July 19, 1989.

3. PAID PRIZES

Section 23-5-1027 MCA states "A minimum of 45% of the money paid for tickets or chances must be paid as prize money".

For the quarter ended June 30, 1989, the prize expense of $1,181,791 reflects 47.46% of net ticket revenues totalling $2,489,845. From April 1, 1989 through June 30, 1989 prizes paid are detailed as follows:

High-tier	$ 102,880
Low-tier	717,746
Big Spin	243,000
	$1,063,626

High-tier prizes reflect prizes greater than $25 paid through Lottery headquarters. Low-tier prizes of $25 or less are paid by the retailer or Lottery headquarters.

4. TRANSFER TO STATE SUPERINTENDENT OF PUBLIC INSTRUCTION

Section 23-5-1027, MCA states "that part of all gross revenue not used for payment of prizes, commissions, and operating expenses is net revenue and must be paid quarterly from the enterprise fund to the State Superintendent of Public Instruction for distribution as equalization aid to retirement funds..." For the quarter ended June 30, 1989, the net revenue amounted to $306,410. This amount was transferred to the State Superintendent of Public Instruction on July 19, 1989.

5. DEFICIT RETAINED EARNINGS

According to the law, the Lottery's net revenue must be transferred quarterly to the State Superintendent of Public Instruction. This transfer should result in a zero retained earnings balance. However, due to adjusting for the net effect of estimated ticket returns and the recording of a fiscal year 1987-1988 expenditure after calculation of the transfer, the beginning retained earnings balance is

($139,435) rather than zero. Correspondingly, because of recording a fiscal year 1988-1989 expenditure after calculation of the transfer, the ending retained earnings balance is (29) rather than zero.

6. PRIOR PERIOD ADJUSTMENT

The prior period adjustment of $5,330 for the quarter and year ended June 30, 1989 reflects expense activity from the previous year recorded in the current period.

7. GAMES

Currently, the Montana Lottery games are instant ticket games. These games provide players the opportunity to win instantly by scratching a latex covering to reveal a prize. Players also have another chance to win by submitting five non-winning tickets or their equivalent for the Big Spin drawing.

8. GAMING SUPPLIER CONTRACTS

Tickets. On March 9, 1987, the Montana Lottery signed a one year contract with Scientific Games, Inc. to purchase lottery tickets. Under that contract, each instant ticket game consisted of 4,800,000 tickets or "other quantity as agreed by the parties."

This contract was extended until March 9, 1989 by letter dated February 23, 1988 and amended on May 5, 1988. The contract amendments address certain ticket specifications, price, and quantity. The amended minimum order quantity is 4,080,000 tickets.

On January 5, 1989, the contract was extended until March 9, 1990. The contract extension amended ticket prize and quantity. The amended minimum order quantity is 2,160,000.

The contract contains specifications regarding ticket design, printing, game ownership, inspection, and prize structure. The contract requires payment within 30 days of ticket receipt.

Scientific Games, Inc., as the vendor, delivered a $776,104 performance bond covering the contract term. The Company also provided an errors and omissions policy covering an ultimate net loss of $5,000,000.

This contract may be terminated when termination is in the best interest of the Lottery with proper notification to Scientific Games, Inc.

Computer Hardware and Software. The Lottery contracted with Scientific Games, Inc. on February 25, 1987, to purchase a used Stratus computer. The computer hardware and software cost $381,243. This contract also covered the acquisition of an Uninterruptable Power Supply (UPS) system for $40,551. The UPS system protects the computer against electrical power surges and failures.

The Lottery signed a separate agreement with Stratus Computer, Inc. on June 2, 1987, for maintenance of the Stratus computer hardware and software. Monthly maintenance totals $4,433.

On July 28, 1987, the Lottery signed a second agreement with Stratus Computer, Inc. regarding the Stratus software license. Under this contract, Stratus Computer, Inc. grants the Lottery a "nonexclusive, nontransferable license" to use the software of the Stratus computer. The proprietary rights and title of the software remain with Stratus Computer, Inc.

Lottery Software. On February 25, 1987, the Lottery agreed to purchase the instant Lottery System (ILS) software package for $840,400. This agreement provides the Lottery a "perpetual, nonexclusive, nontransferable license to use the software solely for the Lottery's own use". The contract allows the Lottery to make 36 monthly payments of $23,344.44 with no interest. The first payment was due June, 1987.

Under the Extension and Second Amendment of Instant Ticket Contract dated January 5, 1989, these monthly payments were reduced to $11,672.22 commencing with the November 1988 payment. Upon expiration or termination of the Instant Ticket Contract the payments will be reinstated to $23,344.44 until the balance is paid in full.

9. PRIZE ANNUITIES

During fiscal year 1989, the Montana Lottery has awarded four Big Spin Jackpot prizes totalling $5,000,000. The Lottery made the initial payments to the winners in the amount of $253,088 and on September 26, 1988, the Montana Lottery awarded annuities in the amount of $2,350,180 to Western National Life. Through these annuities, Western National Life makes the remaining payments to the Big Spin Jackpot winners. As of March 31, 1989, the contingent liability for future prize payments funded through the purchase of annuities was $4,493,824.

OTHER

INFORMATION

MONTANA LOTTERY
SUMMARY OF FINANCIAL DISTRIBUTION
(UNAUDITED)
PERIODS ENDED JUNE 30, 1989

COMMISSIONS - Section 23-5-1016(10), MCA provides retailers a 5% commission on tickets or chances sold. The commission on tickets sold to the retailer gives the retailer $15 per book of 300 tickets. The 5% commission of $149,172 and $669,313 for the quarter and the twelve months ended June 30, 1989, is based on gross lottery ticket sales of $3,255,609 and $13,324,487 respectively.

OPERATING EXPENSES - The Lottery, according to Section 23-5-1007(9), MCA, must prepare quarterly and annual reports on all aspects of the operation of the state lottery, including gross revenue and operating expenses. Gross revenue includes net lottery ticket revenue and license fees. While retailer commissions, by law, are not considered an operating expense, interest expense is considered an operating expense for this purpose. Total operating expenses for the quarter and the twelve months ended June 30, 1989, using the accrual basis of accounting, is as follows:

	Quarter ended June 30, 1989 (Unaudited)	Twelve Months ended June 30, 1989 (Unaudited)
Net lottery ticket revenue	$2,489,845	$11,655,061
License and permits	650	3,600
Total Gross Revenue	$2,490,495	$11,647,661
Operating expenses	847,625	2,757,909
Interest expense	196	914
Total Operating Expense	$ 847,821	$2,758,823

STATE SUPERINTENDENT OF PUBLIC INSTRUCTION TRANSFER - The funds transferred to the State Superintendent of Public Instruction, by law, are not based on a percentage of revenue. The distribution is based on a definition of net revenue. Net revenue is that part of all gross revenue not used for the payment of prizes, commissions, and operating expenses. Net revenue for the quarter and the twelve months ended June 30, 1989, is detailed below:

	Quarter ended June 30, 1989 (Unaudited)	Twelve Months ended June 30, 1989 (Unaudited)
Income before Operating Transfers	$311,711	$2,919,428
Retained Earnings, Beginning of Period	-0-	(139,435)
Prior Period Adjustments	(5,330)	(5,330)
Net Revenue Transferred to State Superintendent of Public Instruction	$306,381	$2,774,663

The net revenue for the quarter of $306,381 differs from the $306,410 transfer by $29. The $29 represents a legitimate fiscal year 1988-1989 expenditure recorded on the state accounting system after calculation of the transfer.

PRIZES - Section 23-5-1027(1a), MCA, states "A minimum of 45% of the money paid for tickets or chances must be paid out as prize money..."

Prize expense is recorded based on the predetermined prize structure percentage for each game. For the quarter ended June 30, 1989, the prize expense of $1,181,791 is 47.46% of the net Lottery revenue of $2,489,845. For the twelve months ended June 30, 1989, the prize expense of $5,300,097 is 45.52% of net Lottery ticket revenue of $11,644,061.

When recording the prize expense, a corresponding liability for high-tier and Big Spin prizes is also recorded. The relationship between prize expense, prizes paid and the change within prize liability is illustrated below:

January 1 through June 30, 1989		Percent of Net Lottery Ticket Revenue (Unaudited)
Prizes paid	1,063,626	42.71
Instabucks	(22,028)	(.88)
Increase (decrease) in prize liability	140,193	5.63
Prize expense	$1,181,791	47.46%

July 1, 1988 through June 30, 1989		Percent of Net Lottery Ticket Revenue (Unaudited)
Prizes paid	$4,858,110	41.72
Purchase of annuities	2,350,180	20.19
Instabucks	(37,876)	(.33)
Increase (decrease) in prize liability	(1,870,317)	(16.06)
Prize expense	$5,300,097	45.52%